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2014

# Managing Budgets During Fiscal Stress: Lessons for Local Government Officials

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IBM Center for  
The Business of Government

Managing Finance Series

# Managing Budgets During Fiscal Stress

## Lessons for Local Government Officials



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# **Managing Budgets During Fiscal Stress: Lessons For Local Government Officials**

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IBM Center for  
**The Business of Government**



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## Foreword

On behalf of the IBM Center for The Business of Government, we are pleased to present this report, *Managing Budgets During Fiscal Stress: Lessons for Local Government Officials*, by Jeremy M. Goldberg and Max Neiman.

Goldberg and Neiman analyze the financial experiences of California local governments from 2007 to 2013 and present findings and recommendations for managing at the local level given budget constraints. Like many local governments across the nation, cities and counties in California were impacted heavily by recent economic problems. This report examines what happened to local California government revenues during this period, which services have been adjusted, how employee benefits have been treated, and what innovations have been introduced.

The report is based on both a web-based survey of 245 California city government officials and face-to-face interviews with chief financial officers in most of the state's major cities (Sacramento, San Francisco, San Jose, Oakland, Riverside, Pasadena and Los Angeles). The authors write, "There has always been much interest in the state with 12 percent of the nation's population. The experiences of California provide lessons for local governments across the nation as they seek to manage the continuing aftershocks of the Great Recession."

The report concludes with recommendations for local governments across the nation. These include:

- Identify and address structural deficits in a finely grained manner, leaving no major budget category unexamined.
- Foster citizen engagement to encourage widespread dissemination of fiscal information in order to enhance the legitimacy of public policy choices.
- Improve the state/local relationship to reduce episodic, convulsive impacts on local public finance.



Daniel J. Chenok



Steve Watson

This report continues the IBM Center's interest in local government. In 2013, the Center issued *A County Manager's Guide to Shared Services in Local Government*, which addresses how local government can save money by improving internal operations. In their survey of local government officials, Neiman and Goldberg found that over 60 percent of respondents rate cost containment as a "very important" or "important" factor in reducing local expenditures in future years.

We trust that this report, along with related IBM Center reports, will assist local government executives as they continue to manage under fiscal constraints.



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# Executive Summary

The Great Recession inflicted the severest blow to local government resources since the Great Depression of 1929. Although the Great Recession officially ended in June 2009 and there are some signs of economic improvement, its corrosive effects on local finances persist.

The experiences of California's cities as they address ongoing budget pressures and insecurity offer important lessons for state and local policy makers. Based on a survey of city officials in all 482 California cities, personal interviews in selected cities, and analysis of publicly available data on spending and revenues, this report describes the experiences of local finance officials and presents recommendations to state and local government leaders.

## Findings

- **Finding One:** As of mid-2013, California cities continued to experience substantial fiscal stress, with majorities of interviewees saying that local finances are fair to poor.
- **Finding Two:** In constant dollars, overall city revenues are flat relative to 2006–2007. Revenue growth generally lags behind the growth of city operating costs.
- **Finding Three:** The long-term trend for assistance from the state and federal government is down, in spite of the short-term uptick in federal stimulus assistance from the American Recovery and Reinvestment Act (Recovery Act).
- **Finding Four:** Although a majority of cities are experiencing continuing fiscal pressure, there is considerable variability among them with regard to revenues.
- **Finding Five:** In California, where there are particularly challenging institutional and legal barriers to raising taxes, cities have relied heavily on raising fees and charges as a way to increase revenues. Tax increases continue to be a problem since they require voter approval. Cities are thus less inclined to seek them unless they have a strategic plan likely to produce voter approval.
- **Finding Six:** Personnel costs are the paramount expenditure drivers. These are influenced by the number of city employees, salaries for current employees, benefits for both current employees and retirees, and pensions for retired employees.
- **Finding Seven:** While California cities have enacted deep, long-term cuts in personnel, services, and capital improvements, cities are still reporting fiscal stress, with the cost of employee benefits viewed as a major impediment to sustained resolution of this stress.
- **Finding Eight:** State government has added to local government's stress by mandating city obligations and reducing state assistance. Local officials also perceive the state as reclaiming local revenue sources, epitomized by California's recent termination of local redevelopment agencies.



- **Finding Nine:** Cities have used the period of crisis and fiscal stress as an opportunity to innovate.
- **Finding Ten:** Cities that operated with long-term budget planning, using durable principles to guide the sustenance and use of reserve accounts, weathered the fiscal storms with less fiscal and service trauma.
- **Finding Eleven:** Community engagement and budget transparency are important and do help, but will not supplant the need to make difficult decisions that involve costs or burdens to residents and community stakeholders.
- **Finding Twelve:** The cost of pensions and benefits is seen as a central challenge to managing fiscal stress.
- **Finding Thirteen:** Revenue increases are important in managing fiscal stress, but achieving them requires leadership and supportive city residents.
- **Finding Fourteen:** Data transparency, innovation, and legitimacy are important contributors to managing fiscal stress.

## Recommendations

This study's recommendations for minimizing the impact of fiscal shocks and facilitating the management of fiscal stress are not startling, yet they may be easy to ignore because policy makers tend to be focused on the short term under pressure from constituents and stakeholders. The recommendations are:

- **Recommendation One:** Identify and address structural deficits in a finely grained manner, leaving no major budget category unexamined. Use strategic and long-term planning to guide local fiscal policy.
- **Recommendation Two:** Foster citizen engagement to encourage widespread dissemination of financial information in order to enhance the legitimacy of public policy choices. Deploy both traditional and innovative ways to stimulate citizen involvement and influence.
- **Recommendation Three:** Improve the state/local relationship to reduce episodic, convulsive impacts on local public finance.

It has become conventional for many scholars to view local governments as fairly helpless in the face of external forces.<sup>1</sup> City governments are often considered unable to manage the external tides that can overwhelm them. They are allegedly too weak institutionally to ward off exacerbating service demands and too vulnerable to aging infrastructure, shifting retail fortunes, the effects of state policies, or external economic shocks. Despite these forces, fiscal troubles that periodically afflict cities and local governments can be moderated and sometimes avoided altogether by disciplined adherence to the recommendations presented here.

1. A body of scholarly literature has explored whether local governments are largely constrained by bigger forces (e.g., Peterson 1981; Mollenkopf 1983; Wirt 1985; Kantor 1995; Pagano and Bowman 1995; Lewis and Neiman 2009). There is a tendency in the scholarly literature to see considerable constraints on local governments' capacity to set their communities' future course. These limits are judged to result from inter-local competition, economic globalization, the strength of pro-growth, land-based elites in local politics, or the restricted role for local governments in most political systems, particularly in the context of U.S. federalism.

# Introduction

This report focuses on how California cities have managed the fiscal stress that overwhelmed many of them during the Great Recession, including answers to the following questions:

- What has happened to city revenues?
- Which services have been adjusted?
- How have cities approached key issues regarding benefits for retirees and current employees?
- How have they managed to innovate during the period of opportunity presented by the fiscal crisis?

California is a particularly appropriate state to examine in terms of how cities have struggled, and continue to struggle, with local fiscal stress. With nearly 500 cities in the nation's largest state, and one of the world's largest economies, California manifests the full array of socioeconomic, institutional, and political variables. The state/local relationship is also marked by contentiousness. This study reveals little trust between state and local officials. Despite that, cities in California (particularly those that have adopted home rule as "charter cities") operate within a statewide tradition of institutional autonomy. (Neiman, 2013)

While the federal government and some state governments can become mired in budget gridlock, local governments are almost universally compelled to enact balanced budgets. It is at the local level where streets, utilities, public safety, recreation, and all the activities of municipalities converge in the politics and policy making of everyday life.

In both years of plenty and times of want, cities must balance budgets and make tough choices to keep their communities safe. When local government choices are difficult and involve cuts and dismissals of employees, the impact on cities is concrete and immediately visible. Each year, thousands of local legislators and officials make budget decisions, almost universally on time and without paralyzing acrimony. In contrast, at the state level in California, the previous decade has been marked by sometimes-unprecedented tardy budgets, laced with seemingly endless bickering between the contending political parties and sometimes between the governor and state legislators.

Indeed, in California, with its volatile revenue structure and dramatic shifts between budget deficits and large surpluses, the result often has been an unpredictable environment for local governments. On a number of important occasions, the state of California has seen fit to manage its own budget problems at the expense of cities, counties, and school districts. Much of the state's decision-making in this regard has eroded the trust of local officials and produced a contentious state/local relationship, culminating most recently in the state government's termination of all local redevelopment agencies.<sup>2</sup>

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2. This report takes no position on the underlying wisdom or justification for state actions regarding state/local relations or any of the policy decisions taken by the state. But it is clear that these decisions have made fiscal life at the city level more complex and difficult to manage and they have clearly produced a community of local officials who are suspicious of their state officials.

## Supporting Research for this Report

**Survey:** All of California's cities were contacted to complete an Internet-based survey about financial conditions in their respective communities. The survey included:

- Overall rating of community fiscal conditions and spending levels
- Assessment of existing and new revenue sources
- Factors that drive or shape city expenditures
- Cutback actions taken by the city to deal with fiscal stress
- Factors that have made it more difficult to manage stress
- Innovations and efficiencies adopted by cities
- How citizens, groups, services, and communities were affected by city budget cuts
- Assessments of local decision-making and political processes as cities managed fiscal stress
- Overall impressions of state/local relationships, particularly regarding local public finance

The survey was sent to city managers, chief administrative officers, and public finance directors between mid-April, 2013, and the end of June, 2013. There was one respondent per city and respondents were assured anonymity.

Of the 482 cities, 245 (51 percent) responded to the survey. The responding cities, however, represent over 67 percent of California's 2010 city population. After comparing non-responding and responding communities on income, poverty rates, age, ethnicity and race, and location, the only significant difference was the size of the city population.<sup>3</sup> The survey, then, likely underrepresents the smaller cities of the state.

**Interviews:** Personal interviews were conducted in July and August, 2013 with selected city officials in eight cities across the state.

**Database analysis:** The survey and interviews were combined with an extensive database that contained fiscal information gathered from the California State Controller's Office, the California Department of Finance, and the U.S. Census Bureau. We also incorporated a measure of fiscal stress that was developed independently by other researchers for the California Debt and Investment Advisory Commission.

Even though the Great Recession is formally considered over, local governments in California are still struggling to manage their finances. In California, state assistance to localities has declined substantially. Property values in many counties are lagging and retail activity is anemic, reflecting that hard-hit middle and working-class families labor under greater economic uncertainty. Additionally, the enormous building activity and property value appreciation before 2008 generated a lucrative source of local revenue, but that ended with the bursting housing bubble.

**Table 1: Mean Level of Total Revenues (Nearest Million): California Cities**

|                    | 1999–2000    | 2006–2007     | 2010–2011     |
|--------------------|--------------|---------------|---------------|
| Total city revenue | \$84 million | \$130 million | \$136 million |

**Source:** California State Controller's Office

3. Non-responding cities had a mean population in 2010 of 43,000 residents, while responding cities had populations over twice as large, with 85,000 residents on average.

In the 1999–2000 fiscal year (Table 1), mean total revenue for California cities was \$84 million. By the 2006–2007 fiscal year that rose to \$130 million, approximately \$19 million above what the rate of inflation would predict. When comparing the 2006–2007 fiscal year to 2010–11, growth in the mean total revenue to \$136 million is, on average, about \$5 million below the inflation rate. In other words, adjusting for inflation, the \$130 million mean total revenue of 2006–2007 would be worth \$141,000,000 in 2011 dollars. The lagging revenue stream and continuing problematic fiscal environment in California cities are reflected in continuing caution and wariness among observers, commentators, and analysts, who are particularly sensitive to signs of defaults, bankruptcies, or deterioration in the local government bond markets.

In the words of one analyst, “Many California cities will remain fiscally challenged over the next few years due to limits on raising revenues and demands for pensions and other spending . . .”<sup>4</sup> Apart from the general impression produced by the notorious and widely covered bankruptcies of Vallejo, Stockton, and San Bernardino, other evidence of continued stress is reported by private entities that monitor the fiscal health of cities.

Moreover, while many California cities are cutting services and staff and seeking alternative revenues, they are engaging in a long-term struggle to manage past, present, and future employee benefits and pensions.<sup>5</sup>

In California, while many cities suffer from ongoing fiscal stress, others have avoided the worst financial difficulties, and some have even prospered. California is, in other words, emblematic of much of the nation. There has always been much interest in the state with 12 percent of the nation’s population. The experiences of California provide lessons for local governments across the nation as they seek to manage the continuing aftershocks of the Great Recession.

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4. <http://www.reuters.com/article/2013/05/14/usa-california-moodys-idUSL2N0DV2SC20130514>

5. San Francisco, San Jose, and San Diego all have resorted to going directly and successfully to their respective voters in order to enact benefits and pension changes. Other, lower profile election campaigns to manage local fiscal stress have occurred as well.

# Managing Fiscal Stress:

## Survey Findings

### **Finding One: California cities continue to experience substantial fiscal stress, with majorities of survey respondents saying that local finances are fair to poor.**

Table 2 illustrates the stress California cities are experiencing. The data compares expenditures for general city service functions for 2006–2007, shortly before the onset of the Great Recession, and for 2010–2011, after the recession ended. The last column expresses 2010–2011 expenditures for each function in terms of 2007 dollars. The data indicate that, in nominal terms, total spending for general government, community development and health, and culture and leisure has declined. The level of spending for police and fire, transportation, and public utilities increased slightly.

**Table 2: Total City Expenditures by Function, Fiscal Years 2000–2006 and 2010–2011 (In Thousands of Dollars)**

|                              | 2006–2007  | 2010–2011  | 2010–2011 in 2007 Dollars* |
|------------------------------|------------|------------|----------------------------|
| General Government           | 5,141,111  | 4,784,739  | 4,410,428                  |
| Police                       | 9,098,523  | 9,353,869  | 8,662,115                  |
| Fire                         | 3,641,108  | 3,865,146  | 3,396,857                  |
| Transportation               | 8,572,259  | 8,732,419  | 8,049,281                  |
| Community Development-Health | 10,239,137 | 10,061,049 | 9,273,972                  |
| Culture-Leisure              | 4,549,554  | 4,301,541  | 3,965,031                  |
| Public Utilities             | 9,824,805  | 11,180,653 | 10,305,989                 |
| Total City Expenditures      | 52,449,140 | 53,722,593 | 53,722,593                 |
| Total Long-Term Debt         | 24,836,689 | 31,926,138 | 29,428,553                 |

**Source:** California State Controller, Annual City Reports, 2006–07 and 2010–11. The figures exclude those for the consolidated City-County of San Francisco.

The only significant increase in spending (2007 dollars) occurred in spending for public utilities and long-term debt. The 2010–2011 expenditures for public safety, expressed as 2007 dollars, declined. For major functions, real expenditures have declined and borrowing has increased substantially. Therefore, even though cities are faced with fixed needs and service demands, they are spending less in real dollars.

In 2009, a time of unfolding fiscal crisis for all of government finance, city public finance officials were asked to rate whether their city's fiscal condition was poor, fair, good, or excellent (see Table 3).<sup>6</sup> In comparing these results to those in our survey, there is an 11-percent

6. The 2009 survey is part of a study done by Neiman and Krimm (2009) for the Public Policy Institute of California. Using the same question and the same response categories in 2009, city officials were asked to rate the fiscal condition of their city.

decline among those claiming that their city's fiscal condition is poor, and a 16-percent increase in respondents indicating that their city's fiscal condition is good or excellent.

**Table 3: Rating of City Fiscal Conditions, 2009 and 2013**

|           | 2009<br>(279)* | 2013<br>(245) |
|-----------|----------------|---------------|
| Poor      | 23%            | 12%           |
| Fair      | 49%            | 44%           |
| Good      | 25%            | 34%           |
| Excellent | 3%             | 10%           |

\* Here, as in other tables, the number of respondents is in parentheses.

**Source:** Project Survey. Unless otherwise indicated, all subsequent tables are based on the responses to the project survey, described above.

**Finding Two: In constant dollars, overall city revenues are flat relative to 2006–2007.**

**Revenue growth generally lags behind the growth of city operating costs.**

When asked how their city compares to others in California with respect to fiscal conditions, 44 percent of 2009 respondents said their city's condition was better than that of other California cities. By 2013, that percentage had climbed modestly, but significantly, to 52 percent, with about the same percent indicating their city was in worse shape than others were (14 percent in 2009 and 13 percent in 2013).

**Finding Three: The long-term trend for assistance from the state and federal government is down, in spite of the short-term uptick in federal stimulus assistance from the Recovery Act.**

Table 4 summarizes the total revenue for California cities in the fiscal year preceding the Great Recession and for 2010–2011. The third column, which shows 2010–2011 figures in 2007 dollars, indicates that all resources have actually *declined* when compared in 2007 dollars. Because of temporary federal stimulus funds provided by the American Recovery and Reinvestment Act, there is a real-dollars bump in federal funding for local governments.

**Table 4: Revenue Sources for California Cities, 2006–2007 and 2010–2011**

|                           | 2006–2007  | 2010–2011  | Percent Change<br>2006–2011 | 2010–2011 in<br>2007 Dollars |
|---------------------------|------------|------------|-----------------------------|------------------------------|
| Property Tax              | 4,290,708  | 4,420,894  | 3.0%                        | 4,075,047                    |
| Sales Tax                 | 3,823,850  | 3,363,747  | -13.7%                      | 3,100,601                    |
| Other Taxes               | 7,186,075  | 6,492,858  | -9.6%                       | 5,984,921                    |
| User Charges, Fines, Fees | 24,518,757 | 25,058,461 | 2.2%                        | 23,098,135                   |
| State Sources             | 2,252,314  | 2,116,896  | -6.0%                       | 1,951,291                    |
| Federal Sources           | 2,137,736  | 2,827,129  | 32.2%                       | 2,605,962                    |
| Total, All Sources        | 54,977,938 | 55,822,186 | 1.54%                       | 51,455,211                   |

**Source:** California State Controller, Annual City Reports, 2006–07 and 2010–11

Even though total local revenues may be lagging or at best approximating the levels of 2006 to 2007, there is substantial variation among cities in how the revenue picture is perceived. The varying perceptions are underscored by how survey respondents view the condition of major revenue sources.

**Table 5: Rating of Current Major Sources of City Revenues**

|            | Property Tax<br>(243) | Sales Tax<br>(240) | Other Taxes<br>(230) | User Charges, Fines, Fees<br>(240) | State Sources<br>(237) | Federal Sources<br>(226) |
|------------|-----------------------|--------------------|----------------------|------------------------------------|------------------------|--------------------------|
| Declining  | 14%                   | 12%                | 11%                  | 11%                                | 79%                    | 80%                      |
| Stable     | 45%                   | 27%                | 59%                  | 66%                                | 20%                    | 19%                      |
| Increasing | 40%                   | 61%                | 30%                  | 23%                                | 1%                     | 1%                       |

\* Rounding errors will produce total percentages of slightly less or greater than 100%. Numbers in parentheses are numbers of respondents.

Their attitudes about current major sources of city revenues are presented in Table 5. Together, these revenue sources account for about 80 percent of total city revenues, although the precise mix will vary among cities.

The results reinforce the declining role of state money in city finances. While federal stimulus money was a fiscal lifejacket during the depths of the Great Recession, the Recovery Act was a temporary program and, understandably, federal help is seen as declining. Only in the case of sales tax revenues do a majority of respondents say that a source of money is increasing, with 61 percent of the cities' public finance officials indicating growth in that revenue source. Because higher sales tax revenue is a result of improved retail activity and consumer confidence, the recent improvements in the economy are likely reflected in this higher sales tax revenue. A plurality of respondents (45 percent) report property taxes as stable, with 14 percent indicating declining property tax revenues and 40 percent with increasing levels of revenue. User charges, fines, and fees also stand out as a stable revenue source, with 66 percent reporting increases in these sources.

**Finding Four: Although a majority of cities are experiencing continuing fiscal pressure, there is considerable variability among them with regard to revenues.**

As of FY 2010–2011, the median per capita total revenue level for California cities was \$1,247, although the variation by community is wide. For example, for the lower 20 percent of communities, the median per capita total revenue figure is \$797, while for the top 20 percent the figure is nearly three times higher at \$2,130 (Table 6). The difference is even greater for specific revenue sources. In the case of property taxes, the lowest quintile of cities have a median per capita property tax revenue of \$45, about one-fifth the \$220 per capita property tax revenue of the highest quintile cities.

**Table 6: Variations in Tax Revenues (2010–2011)**

|  | Per Capita Total Revenue | Median Per Capita Property Tax | Per Capita Sales Tax | Per Capita Utility Tax |
|--|--------------------------|--------------------------------|----------------------|------------------------|
| Lowest Quintile, Per Capita Total Revenue  | \$797                    | \$45                           | \$48                 | \$45                   |
| Highest Quintile, Per Capita Total Revenue | \$2130                   | \$220                          | \$170                | \$128                  |

**Source:** California State Controller, City Annual Report, 2010–11

**Finding Five: In California, where there are particularly challenging institutional and legal barriers to raising taxes, cities have relied heavily on raising fees and charges as a way to increase revenues.**

Tax increases continues to be a problem since they require voter approval. Cities are thus less inclined to seek them unless they have a strategic plan likely to produce voter approval.

Given the difficulty of raising taxes in California, it is unsurprising that only about 21 percent of the responding city officials report raising taxes since 2010–11. In contrast, 50 percent have raised fees and charges. This continues a trend in which California local governments are more dependent on such revenue sources than local governments in other states are. Fifteen percent of the respondents say their cities have increased fines. Fully 55 percent also indicate that they intend to mine new revenue sources. Eighty-one percent of the responding officials will seek voter approval for some of the increases.

So, despite California's improving economic climate and the likelihood that revenues are improving as a consequence, a significant cohort of cities still deal with unstable or inadequate revenue sources. Many are raising fees and charges and considering voter approval for new taxes. Therefore, augmenting revenues is an important strategy for fiscal stress management going forward.

**Finding Six: Personnel costs are the paramount expenditure drivers. These are influenced by the number of city employees, salaries for current employees, benefits for both current employees and retirees, and pensions for retired employees.**

Although increasing revenue is an important element in any strategy to manage fiscal stress, cities face serious challenges in the form of structural barriers to reducing costs. Respondents were asked to rank a list of factors that drive local expenditures and could therefore be the focus of efforts to reduce stress on the cost side. Table 7 reveals that four factors are judged by over 50 percent of the survey respondents as very important drivers of expenditures:

- Employee health benefits (57 percent)
- Retiree pensions (57 percent)
- Aging infrastructure (55 percent)
- Employee salaries (51 percent)

Table 7 confirms government's increasing preoccupation with gaining control over the cost of employee benefits, particularly for health care and retirement. Perhaps a bit more surprising is the salience of aging city infrastructure.

Written comments by respondents indicate that infrastructure refers to much more than an aging fleet of city vehicles, poorly maintained streets and roads, sanitation systems, and the range of physical assets and facilities. It includes older, expensive, less efficient management systems that prevent cities from embracing more efficient ways of billing, managing human resources, purchasing, or even cooperating with other jurisdictions. In the not-so-long run, neglecting investment in all forms of infrastructure, physical and management-related, drives up costs. Respondents realize that patchwork and plugging holes in an increasingly obsolete or decrepit set of systems can produce momentary, illusory savings, but may delay a community from experiencing the improved performance that all forms of infrastructure upgrades can bring.

Table 7 shows that working on conventional operating cost containment (e.g., energy and maintenance costs and vendor contracts) is rated as important or very important by more than 60 percent of the respondents. It is surprising that local debt-related issues (including interest on bonds) seem less important to city officials than local government observers would have predicted.



**Table 7: Importance of Various Factors Driving Local Expenditures**

|                                | Very Important | Important | Somewhat Important | Not Important | N   |
|--------------------------------|----------------|-----------|--------------------|---------------|-----|
| Employee health benefits       | 57%            | 30%       | 12%                | 1%            | 238 |
| Retiree pensions               | 57%            | 22%       | 13%                | 8%            | 234 |
| Aging city infrastructure      | 55%            | 26%       | 16%                | 3%            | 234 |
| Employee salaries              | 51%            | 33%       | 14%                | 2%            | 239 |
| State government mandates      | 41%            | 37%       | 20%                | 2%            | 237 |
| Federal regulations/mandates   | 30%            | 34%       | 29%                | 7%            | 236 |
| Retiree health care costs      | 30%            | 22%       | 24%                | 24%           | 225 |
| County contracts               | 22%            | 19%       | 32%                | 27%           | 230 |
| Operating cost containment     | 16%            | 48%       | 32%                | 4%            | 237 |
| Debt service/interest on bonds | 11%            | 19%       | 32%                | 39%           | 234 |
| Contracts with private vendors | 10%            | 40%       | 40%                | 10%           | 237 |
| Growing city population        | 8%             | 14%       | 28%                | 51%           | 233 |
| Short term borrowing costs     | 5%             | 6%        | 21%                | 68%           | 231 |

After decades of population pressures being cited as an important cause of spending pressures on cities, it is surprising to see the relatively low importance rating for this factor. However, data regarding California population growth indicates that it has slowed dramatically since 2000 (Pitkin and Myers, 2011). Whatever the implications of slower population growth, one is likely to be less pressure for cities and other local governments to spend on the range of service and infrastructure demands traditionally posed by increases in population.

**Finding Seven: While California cities have enacted deep, long-term cuts in personnel, services, and capital improvements, cities are still reporting fiscal stress, with the cost of employee benefits viewed as a major impediment to sustained resolution of this stress.**

Over 90 percent of the respondents have implemented service cuts (Table 8). At least half have taken one or more of the first 10 of the 13 actions listed below.

**Table 8: Actions Taken to Manage Fiscal Stress**

|   | Yes | No  | N   |
|---|-----|-----|-----|
| Cut spending for services                   | 93% | 7%  | 239 |
| Eliminated unfilled positions               | 87% | 13% | 235 |
| Reduced benefits for new employees          | 87% | 13% | 237 |
| Imposed a hiring freeze                     | 74% | 26% | 234 |
| Laid off employees                          | 66% | 34% | 235 |
| Raised fees                                 | 66% | 34% | 235 |
| Reduced-eliminated contribution to reserves | 59% | 41% | 233 |
| Reclassified open positions to lower levels | 58% | 42% | 229 |
| Reduced benefits for current employees      | 56% | 44% | 238 |
| Implemented work furloughs                  | 50% | 50% | 234 |
| Encouraged early retirement                 | 44% | 56% | 235 |
| Reduced wages                               | 40% | 60% | 235 |
| Raised taxes                                | 33% | 67% | 235 |

Nearly 90 percent have eliminated unfilled positions and reduced benefits for new employees; nearly 75 percent have imposed a hiring freeze; and 66 percent have laid off employees. Significant percentages report reducing and even eliminating their financial reserves, reclassifying positions to lower levels, reducing benefits for current employees, and implementing work furloughs. The approach used least frequently has been raising taxes, but even here, one-third report using this strategy.

Study respondents also rated factors that make it more difficult to manage fiscal stress or balance budgets (Table 9). Nearly 60 percent select pension systems as very important stress factors—17 percent higher than for the next category considered very important, health care cost. The third most important factor is declining property values. The only factors considered important by less than 50 percent of the survey respondents are home foreclosures, principal payments on bonds, interest on bonds, or interest rate swap deals. The results reinforce that city officials do not see borrowing and related costs as a barrier to managing stress, despite the fact that the amount of borrowing by city governments has increased substantially in recent years.

**Table 9: Importance of Selected Stress Factors That Might Make it More Difficult for City to Manage Fiscal Stress or Balance City Budget**

|                                    | Very Important | Important | Somewhat Important | Not at all Important | No. of Respondents |
|------------------------------------|----------------|-----------|--------------------|----------------------|--------------------|
| Pension system in general          | 58%            | 28%       | 11%                | 3%                   | 227                |
| Health care of current employees   | 41%            | 38%       | 19%                | 3%                   | 231                |
| Declines in property values        | 41%            | 27%       | 21%                | 11%                  | 227                |
| Salaries of current employees      | 37%            | 37%       | 25%                | 2%                   | 250                |
| Unfunded liability of pension fund | 37%            | 29%       | 21%                | 12%                  | 224                |
| Decline in retail sales            | 35%            | 27%       | 24%                | 14%                  | 225                |
| Health care for retirees           | 28%            | 22%       | 25%                | 25%                  | 213                |
| Unemployment                       | 20%            | 32%       | 30%                | 18%                  | 226                |
| Foreclosed houses                  | 14%            | 19%       | 31%                | 36%                  | 220                |
| Principal repayment on bonds       | 7%             | 9%        | 36%                | 49%                  | 214                |
| Interest due on city bonds         | 6%             | 14%       | 35%                | 44%                  | 217                |
| Interest rate swap deals           | 1%             | 8%        | 17%                | 74%                  | 184                |

It is also clear that a combination of corrosive factors including high unemployment rates, high foreclosure rates, stagnant or declining sales, and property tax revenues have made it more problematic for local officials to manage fiscal stress.<sup>7</sup>

In sum, many cities now face a challenging cost structure driven primarily by pension and health care costs. There are also localities with ongoing hardships posed by struggling local economies and disadvantaged demographic profiles. These all impact local capacity to maintain services or manage fiscal stress.

7. For example, higher median household income in a city, lower unemployment, and fewer home foreclosures tend to be correlated with one another.

# State/Local Tensions: Survey Findings

**Finding Eight: State government has added to local government's stress by mandating city obligations and reducing state assistance. Local officials also perceive the state as reclaiming local revenue sources, epitomized by California's recent termination of local redevelopment agencies.**

Over the past decade, a series of state actions have caused persistent concern to local governments. These include:

- Termination of all local redevelopment agencies
- Ongoing efforts by the state to realign certain responsibilities and shift them to local government
- State legislative proposals to reform or change municipal bankruptcy law in order to require more hurdles for municipalities before they can pursue bankruptcy
- Intermittent unpredicted changes and struggles concerning city resources<sup>8</sup>
- The belief, accurate or not, that state legislators have little experience or empathy with city or local affairs
- Ever-present grievances concerning state mandates and proper state compensation for them<sup>9</sup>

Officials considered the relative importance of these actions and several others to city management of finances and budgets.

On February 12, 2012, California's redevelopment agencies were dissolved due to a 2011 action by the state legislation. The legislation was upheld by the courts. Aside from the merits of the arguments surrounding what the state did, there is no doubt that for many cities, the fiscal blow was substantial. Because the redevelopment battle is recent and its aftermath continues to produce hard feelings, it is not surprising that 79 percent of respondents consider the ending of redevelopment as very important. City officials also assign high importance to a number of other issues, including changes in city finance, state mandates, realignment of services and finances, and the amount of local experience among state legislators. Unhappiness

8. Particularly since the enactment of Proposition 13 in 1978, California state government and the state's localities have been locked in a complex web of relationships—sometimes constructive, often rancorous. Since 1978, localities are more dependent on the state for finances; the state's efforts to manage its own fiscal stress have often involved decisions that have complicated local finances and, from the viewpoint of the locals, reduced state support that rightfully ought to come to them. The "rightness" of the state or local position is not the issue here. It is the lack of trust and obliteration of comity that is the paramount issue.

9. California has a system of compensation to localities for state policy or procedural mandates. Virtually all evaluations of the process, including independent assessments, indicate that the process is fraught with advocacy and dissatisfaction. It is likely inherent that localities will be unhappy with state mandates and there is widespread belief among state officials that local governments exaggerate state mandate costs. In any case, the degree of ongoing conflict and resentment in California is particularly high (Cruz, 2005). Although California has a process for mandate reimbursement, it has rarely produced agreement. Indeed, as of 2013 local governments were claiming that the state of California owed local governments nearly \$2 billion in unpaid mandate claims (Miller, 2013).

with the state is obvious, although it is notable that a large number of new legislators with local government experience were ushered into the state legislature in November, 2012.<sup>10</sup>

**Table 10: Percent Rating State Factors Affecting City Management of Budgets and Fiscal Affairs as Either Very Important or Not at All Important**

|                               | Very Important | Not at All Important |
|-------------------------------|----------------|----------------------|
| State ending redevelopment    | 79%            | 8%                   |
| State changes in city finance | 67%            | 1%                   |
| State mandates                | 65%            | 1%                   |
| Issue of finance realignment  | 63%            | 1%                   |
| Experience in local affairs   | 60%            | 3%                   |
| Change in bankruptcy law      | 21%            | 25%                  |

A number of California cities have declared bankruptcy in the past few years, and these have received much media attention. In fact, California is relatively permissive about bankruptcies compared with other states (Pew, 2013), and public employees and their local and state organizations have come to believe that this “easy” path to bankruptcy jeopardizes them. Their reasoning is that bankruptcies are used to blow up union contracts and deprive their members of the salaries and benefits that were previously negotiated. One result is that the state has been pressed to introduce legislation that would make it more difficult for cities and other localities to pursue federal bankruptcy.

The resulting battle over such legislation has resulted in a very modest change in state law, which now requires that cities undergo some additional steps before moving toward bankruptcy.<sup>11</sup> But this still leaves California in a position where relatively few state-level procedures stand in the way of a city moving towards bankruptcy, notwithstanding the many other inherent barriers and disincentives for a city to launch bankruptcy proceedings. Nevertheless, given the controversy over this issue, it is surprising that it ranked low in importance.

In California, the state plays an important, but unpredictable, role in affecting local government finances. Much of the unpredictability derives from the absence of a systematic, sustained, or strategic view about what local government should be—the extent of its authority, control over resources, and degree of autonomy from the state. There is a fairly strong tradition of local autonomy in California, but a number of dynamics, particularly in recent decades, have introduced a persistent uncertainty and contentiousness into the state and local government relations mix. Perhaps most important is Proposition 13 and the variety of ad hoc, sometimes convulsive, ways that the state has managed the consequences of the always-controversial tax-cutting provision, along with its progeny in statute and constitutional amendments.

Moreover, California has itself experienced ongoing fiscal stress and volatility and has managed its own fiscal problems partly by major changes in local finances—sometimes taking, borrowing, and delaying resources viewed by localities as belonging to them, and otherwise eroding trust and comity between the levels of government. Local governments in turn have

10. Indeed, 69 percent of the current California Assembly has local government experience (Caygill, 2013).

11. AB 506, enacted in 2011, now requires California cities, counties, and special districts to work collaboratively and in good faith with creditors, employee groups, and other interested parties to resolve their claims. The process now requires that a local government and affected parties select a “neutral evaluator” to review the local government’s fiscal condition. The neutral evaluator has limited powers and may not impose an agreement on any party. If at the conclusion of the neutral evaluation process no resolution has been reached, the local government may file for Chapter 9 (bankruptcy) relief (LAO, 2012b).

resorted to the ballot box to seek protection from what they perceive as state raids on local treasuries, in the process ratcheting up the disharmony (Barbour, 2007). Much of the acrimony and distrust is currently made more intense in the aftermath of the state government's dissolution of all city and county redevelopment agencies.

Finally, California's political system has, for many reasons, produced an intense and complex interest group competition at the state level, with public employees organized to harden the state's policies and institutions against local government fiscal actions that would come at the expense of public employee benefits and salaries. The intense interest group activity at the state level is just part of an exceptionally high-stakes "war of all against all" that regularly occurs in Sacramento, involving not only public employees, but organizations representing other units of government (cities, counties, special districts) and the entire panoply of private sector and nongovernmental organizations that populate Sacramento's policy making arena. Cities, like all other organized interests in the state, have joined in the political free-for-all and use the same techniques, including the instruments of direct democracy, to protect their interests (Barbour, 2007)

In the absence of trust in the good-faith intentions of the state, local governments in California are not sufficiently assured and motivated to work on a new set of policies. For example, it would be helpful to produce some type of fiscal tool or warning system to identify fiscally troubled communities, without any specter or actual threat of state punishment or advantage-seeking, but out of caution and a mission to assist. Such a role could involve ongoing work to encourage best budget practices, and even technical and financial assistance to communities. It is unlikely, however, that local governments in California, suspicious of the state government's motives, would embrace any such state-initiated proposals at this time.

# Lessons Learned from Selected Cities: Interview Findings

In addition to the survey, personal interviews were conducted with chief financial officers in Sacramento, San Francisco, San Jose, Oakland, Riverside, Pasadena, and Los Angeles. The findings from these interviews are consistent with the survey findings.

## **Finding Nine: Cities have used the period of crisis and fiscal stress as an opportunity to innovate.**

In the midst of post-recession fiscal realities, local governments across California are now operating within a “new normal.” On the one hand, the Great Recession traumatized local governments throughout the nation. Unlike previous post-World War II recessions, this time recovery has been anemic and government resources have only recovered very slowly. Local governments have recovered most slowly of all, as many suffered a withered revenue base. Of course, there are exceptions, but for many cities the new normal has meant taking stock of the impact of the Great Recession, being more vigilant in a less predictable world, and adopting constructive innovations.

Simultaneously, many cities have to confront ongoing, if not increasing, demands for services from residents, aging infrastructure and capital needs, lagging or slow-growing resources, and a shrinking city government workforce. These realities have led to fiscal policy and budget reforms in cities and opportunities for local government innovation and service delivery enhancement. Some of these innovations are aimed at internal fiscal policy making processes and efficiency improvements, including transitioning to cross-departmental collaboration tools, cloud-based solutions, outsourcing services to vendors, and new community engagement tools, including, for example, crowd-funding and crowdsourcing feedback and idea soliciting from residents to accompany annual budget prioritization and meetings.

Table 11 focuses on efforts by localities to change or adopt practices and policies. Of the nine items, about 60 percent or more of the responding community officials have tried one or more of the top five innovations and efficiencies, with the greatest emphasis on technology (75 percent) and contracting out (74 percent). Nearly 50 percent have adopted changes in pensions for current employees. Although some of these items may be readily embraced—e.g., greater use of technology or cooperative agreements with other cities—others are fraught with political and other substantial barriers. Negotiating new contracts with vendors and taking on salaries, benefits, and pensions can be painful and politically hazardous. Cities in California are trying new things to resolve fiscal difficulties. Some are fairly straightforward, while others involve difficult and sometimes contentious decisions.

**Table 11: Innovations and Efficiencies Adopted in Cities in Past Five Years**

| Innovations and Efficiencies (Focused Mainly on Cuts/Reductions in Budget) | Percent Adopting |
|--|------------------|
| Greater use of technology (hardware)                                       | 75% (235)        |
| Contracting out services to private vendors                                | 74% (234)        |
| Concessions from city employees in salaries                                | 64% (234)        |
| Cooperative agreements with other cities                                   | 59% (231)        |
| Changes in employee health benefits  | 57% (236)        |
| Changes in pensions for current employees                                  | 47% (235)        |
| New or revised contract with the county                                    | 39% (230)        |
| New or more pro-bono assistance from private sector                        | 32% (230)        |
| Ending county contracts and having city take on service                    | 14% (225)        |

**Finding Ten: Cities that operated with long-term budget planning, using durable principles to guide the sustenance and use of reserve accounts, weathered the fiscal storms with less fiscal and service trauma.**

Several of the cities where interviews were conducted had been guided during the Great Recession by already-established programs and principles. California governments at all levels had been dealing with episodes of fiscal stress since the passage of Proposition 13 in 1978, followed by serious economic downturns in the early 1980s, early 1990s, early 2000s and, most recently, as a consequence of the Great Recession.

**Case Example One: An Inland Southern California City.** One interviewee explains that his city's long-standing prudence and established principles about how to grow expenditures and manage its reserve were critical in preventing the city from slipping into dire crisis. That city, an inland Southern California municipality, had been particularly hard-hit by previous downturns and the closure of military bases, and so it had specific experience with sudden fiscal blows. The Great Recession hit this city very hard and by 2010, its unemployment rate was near 15 percent, with a high volume of home foreclosures, as well as plummeting retail sales. The city is not that different from other communities that have slipped into financial emergency and managed to steer through the storm and recover in solid fashion. The city's median household income is less than Vallejo's (which went bankrupt in 2008) and about the same as Stockton's (which filed for bankruptcy in 2012).

This Southern California community was able to make hard decisions across the spectrum of budget issues—employee pay and benefits, contracting with private vendors, and program cuts. Based on lessons learned from previous crises, this city adhered to a strict policy of building a reserve during good times—one that is substantially higher than the average city's. The healthy reserve was carefully drawn from during the recent crisis. Indeed, this city's target of a 15 percent reserve account is among the most ambitious among large cities in California. At latest count, this city had exceeded its reserve account target by several percentage points.

Another factor mentioned by this city's finance director is that the city has a long tradition and reputation of good governance that harkens back to the progressive era of the late 19th and early 20th centuries. As a result, the city has attracted some of the region's best and most committed municipal administrators. The director also notes that the city works diligently with its employees to establish comity and trust, which proved critical in the city's ability to make needed adjustments in benefits and positions in the past five years. As the city's finance director puts it: "We have a long history of fiscal discipline and conservative fiscal practices."



**Case Example Two: A Los Angeles Suburb.** Similarly, a city administrator in one of Los Angeles's larger suburbs shares that his city designed a five-year fiscal plan focused on confronting the structural deficits in virtually every fund. In 2009, that city began an aggressive approach to managing its structural deficit, with a focus on cost-cutting within each fund. The plan also includes a series of revenue-generating tactics tied to the city's reserve account, including issuing pension obligation and other bonds in the current low-interest environment, with a goal of achieving more than 20 percent of the general fund (operating budget) for the city's reserve account. The city's top administrator says that "taking on debt should always be scrutinized" because there are arbitrage opportunities in selected environments. This city also pushed hard with a long-term plan to contribute to and reach a rainy-day fund of 20 percent of the city's budget.

**Case Example Three: Other Localities.** In cities that did not fare as well in the aftermath of the recession, such as San Bernardino, reserve accounts were aggressively used to backfill deficits in the city budget, city expenditures rose more rapidly than usual during the 2000–2006 period, and the "good times" provided opportunities to take on projects and enhance city benefits. Essentially, the rapid draining of the reserve or rainy-day funds reduced the city's ability to respond to its needs as fiscal conditions remained mired in stagnant revenues and fixed or growing costs. In addition to the reserve account depletion, cities with high-profile fiscal emergencies seem not to have the kind of trust or relationship with their workforce necessary to negotiate either temporary or longer-term givebacks or cuts in benefits or salaries required to reduce the city budget gap.

In interviews, a set of implicit principles emerged from managing the Great Recession. One factor associated with higher levels of fiscal stress is a greater-than-average increase in expenditures between FY 1999–2000 and FY 2006–2007. The housing boom in the mid-2000s accelerated spending in some California cities. In at least one case, an interviewee recommends a system of budgeting that would be constrained in principle by the city's long-term revenue growth trends. In this case, the city uses the average revenue growth over the previous 10 years and limits any programmatic or personnel growth to what that average can support. Revenues above that amount are limited to reduction of liabilities and to one-time or short-term projects. It is a simple notion, but a prudent one. It is also subject to the changing priorities of elected officials, who are, according to the interviewees, under considerable pressure from various constituents to spend and to provide benefits—higher salaries, higher benefits, a new park, or a major investment in facilities.

**Finding Eleven: Community engagement and budget transparency are important and do help, but will not supplant the need to make difficult decisions that involve costs or burdens to residents and community stakeholders.**

One factor in public unhappiness with government at all levels is frustration with the budget process. The public finds the process too complex and opaque, they are insufficiently aware of how their tax dollars and other city resources are expended, and they are often skeptical about the efficacy or efficiency of what their government is doing. City officials know this, and there is evidence that they are addressing the need to get more buy-in from residents, particularly when tough decisions have to be made about allocating resources or making painful service cutbacks.

Cities do vary in the degree to which they deploy technology, behavioral science, and traditional methods of engaging citizens. With the exception of one official who was interviewed, the interviewees all have made extensive efforts to engage residents and stakeholders. The paramount reasons for doing so include measuring community sentiment, discerning priorities, taking note of disagreements, and assessing cross-city differences. The methods of engagement



range from focus groups, citywide telephone surveys, smartphone-based applications, deliberative democracy, and more intense use of traditional methods: public meetings and neighborhood-focused and citizen-led meetings.

**Case Example One: Los Angeles.** The experience of Los Angeles underscores the importance of formalized neighborhood councils. Since 1999, Los Angeles has had an institutionalized system that fosters broader participation and strengthens the forums in which neighborhoods can operate in a decentralized, diverse urban area (Musso, et al., 2007). The neighborhood council model is more suited to a city like Los Angeles, but it does suggest a way that neighborhood groups find bridges to link voices across the city and project influence on policy making. Los Angeles annually turns to the neighborhood councils to survey budget priorities. In smaller communities, more compact and perhaps less diverse, the need to involve neighborhood councils in the process might not be as great.

**Case Example Two: San Jose.** San Jose provides a model of city engagement that demonstrates a willingness to experiment with technology in service delivery and citizen feedback and in forging civic engagement. The city also has a very intense system of resident engagement in “the old-fashioned way.” As part of the budget formulation process, the city conducts numerous neighborhood meetings within each city council district, systematically aggregates the results of the meetings and provides feedback, and works with council members and neighborhood organizations to consider how best to incorporate the results of the process into the annual budget document.

In addition, much new technology is being deployed among all cities, and vendors and software developers have strong incentives to market these technologies. Although progress has been made in these areas, much remains to be done to integrate the results of social networking, website interactions, and smartphone applications with broader feedback to city residents. Such feedback can be used not only to improve service delivery, but also underscores the city’s responsiveness and demonstrates that individual residents are making a difference.

**Finding Twelve: The cost of pensions and benefits is seen as a central challenge to managing fiscal stress.**

The survey results indicate that most of California’s cities have endeavored to control and stabilize, if not reduce, costs. Although all cities have become far more aggressive about controlling their everyday costs—supplies, energy, technology, maintenance, and vendor contracts—most important are personnel cost savings. Majorities of the cities in this study implemented workforce-related cutbacks, including eliminating unfilled positions, reducing benefits for new and current employees, imposing hiring and wage freezes and furloughs, and even laying off considerable numbers of public employees. A fairly substantial proportion, albeit a minority, even encourages early retirement and imposed wage reductions. The personal interviews indicate that cities have implemented actions that have become more conventional in terms of cost savings, including closing facilities, curtailing hours, using more civilians for some public safety staffing, and outsourcing certain services to private vendors.

All of the officials interviewed mention the need to focus on personnel costs for major cost savings, but the degree to which this is done strategically, rather than on an ad hoc basis, varies considerably. In the state’s largest cities salaries, benefits, and pensions seem particularly contentious. Especially after 2010, a host of local ballot measures at the county and city levels dealt with pensions and benefits for public employees. Among the most widely watched were those in cities like San Diego, San Francisco, and San Jose. There were, however, also pension reforms on the ballot in smaller cities and some counties throughout the state, and all but one were successful. That failure, in San Francisco, was followed by a less dramatic but

still significant successful pension reform proposal, notable for its broad-based support, including among public employees.

A number of cities resorted to or threatened ballot measures to achieve substantial changes in wages and benefits, and some of these are the subject of litigation. Should these ballot-based measures fail in the courts, the cities in which they were enacted will have to find ways to fund higher-than-planned-for benefits and wages, cut services or some combination of the two. Still other cities were able to negotiate savings from their workforce without acrimony or elections. These latter results are less vulnerable to court decisions and more dependable, but might not be sufficient to ease the financial burden of employee benefits.<sup>12</sup>

The task facing local governments is underscored by the fact that cities have already made very substantial cuts to their local workforce. California's city government workforce, like that of many other states, experienced severe reductions during the Great Recession, and much of that reduction continued through 2012. In addition, according to the State Controller's Office:

- There was an 11 percent decline between 2009 and 2011 in the average number of city employees (from an average of 684 employees per city in 2009 to 612 in 2011).
- In the aggregate, as of 2009, there were 327,760 city employees in California and by 2011 that number had declined to 293,525.

For example, in San Jose between 2002–2003 and 2011–12, the city's full-time equivalent workforce dropped from about 7,445 employees to approximately 5,427, a 28 percent decline in the city's workforce. The most precipitous decline in positions began in the period during and after 2007–2008. At the start of 2007–2008 the city's full-time equivalent workforce stood at just over 7,000 employees, a drop of about 500 employees over 2002–2003. Between 2007–2008 and 2011–2012, the number of positions dropped by another 1152. In other words, of the total loss of positions between 2002 and 2012 (N=1578), nearly three-quarters were lost between 2007–2008 and 2010–2012 (Office of the City Auditor, 2012).

The San Jose experience is fairly typical among stressed California cities. The result has been a host of service reductions and cutbacks, perhaps the most common involving deferred maintenance and delays in infrastructure maintenance. It is not surprising that as a result nearly 75 percent of responding cities indicate that capital projects and the maintenance of public facilities were seriously affected by budget cuts. Over 60 percent of responding cities say that streets and roads were seriously affected by budget cuts as well. Sizable percentages of cities also reduced art and cultural activities, public safety response times, and code enforcement for buildings and sanitation.

The personal interviews reinforce the survey results. For example, each interviewee reports service reductions including shuttering or curtailing hours at museums, reducing or terminating youth services, fire department brownouts, and other public safety services and response. Some of the cities reduced library and community center hours and laid off park maintenance staff.

In short, savings from the workforce are critical components of cities' efforts to steer through the financial crisis of the past five years. A key approach is for cities to nurture as much trust and comity between management and the workforce as possible, so that they can make more certain progress without the rancor that elections-based reforms have. Cities that are required to turn to the ballot box to produce these savings, however, are perhaps likely to produce higher savings, but possibly at the expense of their workforce morale. Yet, it is also clear from

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12. The project has not been able to compare the ballot-election-based pension and benefit reforms to those that were negotiated without election battles, and so it is not possible to determine the kinds or the magnitude of the savings that communities achieved.

the study that there are times when cities might not have any choice but to go to the voters. In states where going to the voters is not an option, policy makers might find their options more constrained.

**Finding Thirteen: Revenue increases are important in managing fiscal stress, but achieving them requires leadership and supportive community residents.**

A paramount objective of city government is to restore and, if possible, enhance the local revenue base as much as possible. The personal interviews provide additional insights about how cities are approaching improved fiscal conditions. As the survey results indicate, cities have raised fees, sometimes raised taxes, and issued debt in order to balance their budgets and pay for a variety of things, including pension obligations.

The city officials interviewed all understand the need for revenue, but they also understand that Proposition 13-type constraints are a given. However, apart from increasing fees and service charges, they are also wary of tax increases unless they have a solid plan for winning the election that will almost always be required to raise taxes. The fact is that there are structural and state constitutional constraints on revenue base increases and raising revenues is not a “slam-dunk” way to get over the fiscal hump.

If revenue is to be increased, the data and interviews suggest the following ingredients will be needed to produce a successful revenue increase:

- Leadership and an intensive education campaign focused on targeted services tied to specific revenue streams
- Ironclad assurances that the spending will primarily be on benefits for the residents and not on operating costs

A campaign of this sort should be a high-profile exercise in community education, involving focus groups, surveys, and neighborhood meetings, along with intensive, ongoing interaction with the community and stakeholders by elected officials.

**Finding Fourteen: Data transparency, innovation, and legitimacy are important contributors to managing fiscal stress.**

Increasingly, the traditional method of delivering services and engaging “customers” in the public sector seems more opaque and unresponsive to the residents on all levels of government from local to federal. In California, the state launched the [Data.CA.gov](https://data.ca.gov) site and cities across California have been hard at work since 2009 to pass “open data” policies. Some have already succeeded.

However, it is local governments that have done the most testing and introducing of technology-based innovation in both the demand and supply side of public-sector service delivery. Open data policies are often complemented by an interactive, online platform to push them forward. Specifically, the system of APIs for developers (e.g., community based “hackathons”) to develop new applications, and the ongoing release of data that include public safety, health inspection and budget, are, according to some city officials, bringing residents and citizens closer to understanding and cooperation with government.

Interviews reveal aggressive use of mobile applications for residents to share information or report a non-emergency problem to the city. These applications include SeeClickFix in Oakland, or Riverside’s Mobile 311, which generates a service request to remove graffiti or repair a pot-hole. These mobile innovations are often complemented by webpages featuring options to share ideas with the city to “build a better community” such as EnvisionSacramento, or a platform

that reveals a closer look at a city's fiscal and economic health, such as San Francisco's SFOpenBook.

In many cases, these technologies are complemented by innovative partnerships with organizations such as Code for America and the Fuse Corps Fellowship. These organizations are helping cities leverage technologists and executive talent on time-intensive, impact-oriented projects. In this regard, the personal interviews reveal that there is a pervasive willingness of cities to be "beta-sites" or "incubators" of new ideas (not just technologies), that enhance services and engage residents.

While this report does not focus extensively on civic innovation, the interviews reveal that cities are considering and implementing new ways to be nimble and enhance services while confronting the challenges of declining revenues and resources. They clearly see these activities helping to boost official legitimacy for such fiscally relevant matters as raising revenues or making difficult service and personnel cuts.

The most important argument in favor of open data rests not only on democratic principles, but on efficiency. Providing data on common platforms and making this data accessible will give the public the means to independently assess fiscal decisions and even service performance relative to expenditures (Joffe and Neiman, 2013). In short, not only will widely usable platforms comport with democratic norms of accessibility, they will also, in effect, crowdsource data in a way that should improve oversight of public performance.

# Recommendations

Recommendations based on the results of this project can be categorized as follows:

- Identifying and tackling structural deficits
- Fostering citizen engagement
- Improving the state/local relationship

**Recommendation One: Identify and address structural deficits in a finely grained manner, leaving no major budget category unexamined. Use strategic and long-term planning to guide local fiscal policy.**

Cities will benefit from having an ongoing, cumulative look at the nature of their general fund, going back at least a decade. Providing such a retrospective look at the city budget permits a city to examine the points at which budget stress and shortfalls begin to appear and relate them to specific events and decisions and commitments made in the community. Separating such factors from exogenous events like national, state, or regional economic downturns is important to distinguish those things that cities cannot control from those that they can. This report also indicates that cities' fiscal conduct during good times is an important factor affecting the level of stress a city faces when times get tough.

In other words, a community needs to know itself. There is ample evidence that cities can succumb to a kind of collective denial. Having a long-term perspective, then, on where a community has been, how far it has traveled, and where it will go, if it continues on the current path, is critical.

Insofar as the current fiscal condition in a city is stressful, in that budget shortfalls continue to stress city residents and officials, the city needs to formulate a strategy and set of accompanying actions to bring the city's finances into balance. Clearly there are three components that can be addressed:

- Revenues
- Cost savings
- Service reductions and program eliminations

The survey data and interviews provide examples of how to strategically address revenues, cost, and services. Where shortfalls are substantial, cost savings necessarily will have to come from areas of largest cost—personnel. It is obvious that any plan to eliminate a structural budget shortfall, no matter how improved the local economy, needs to be managed strategically for the long term.

In managing local fiscal stress, developing principles that guide where the focus is must be paramount. For example, there must be solid empirical validation of which cost components

most stress city budgets. The likely cuts and local pain that result will be more readily dealt with if the legitimacy of local actions is grounded in a solid, objective fiscal analysis. Of course, there should also be strong commitments to achieving savings and cost-recovery tactics that can be accomplished by doing things in a “smarter” way. It is also useful for cities to explore possible synergies and cooperation with other local jurisdictions, as well as more intense and potentially mutually beneficial relationships with the private sector. Yet there must also be a realistic expectation that while cooperation with the private sector and other localities can be beneficial, and efficiencies and smart administration are inherently important, these strategies rarely produce enough savings to end structural deficits or chronic shortfalls.

Cities are governed by local legislatures and elected executives (when the mayor plays a major substantive and administrative role). Elected officials, who in most cases have supervisory relationships with the top administrator, sometimes have incentives that do not easily harmonize with plans to manage fiscal stress. Constituency pressures and the need for coalition-building and fundraising can distract elected officials from the technical, professional objectives of city administrators, as well as the long-term fiscal health of the community. The temptation to satisfy a constituency with a project or program is great, and elected officials are rarely rewarded for the salaries they have cut and the loss of services and amenities that citizens experience.

An important way for local officials, then, to have more leverage in making the hard decisions is to create a formal and ritualized process for committing a city to its plans for managing fiscal stress. Having a council and its mayor or professional manager aligned in an explicit way behind a carefully crafted strategic plan on managing fiscal stress is a critical factor in providing each elected official some buffer against constituency and other kinds of pressure to do things inconsistent with reducing fiscal stress or with sound professional standards.

There is no guarantee that elected officials will abide by a plan. But the chances of having everyone pulling in the same direction and for the long haul are greatly enhanced if there is a formal commitment to some plan. Also, as a city makes difficult decisions regarding matters like pension reform, multiple wage tiers for current and future employees, changes in health care benefits, or rolling brownouts, the chances of carrying through on these difficult decisions is facilitated by a kind of city “resolution in support of a deficit-reduction plan” to which all key local officials sign on.

**Recommendation Two: Foster citizen engagement to encourage widespread dissemination of financial information in order to enhance the legitimacy of public policy choices. Deploy both traditional and innovative ways to encourage citizen involvement and influence.**

Virtually all communities encourage citizen engagement to varying degrees all the time. In managing fiscal stress, citizen engagement is critical. Citizen receptivity to and acceptance of inevitably painful or disruptive decisions are decisive for enabling a city to carry through on some of the most important decisions, whether increasing fines and fees, raising an existing or implementing a new tax, reducing a service, closing a facility, or producing the political heft necessary to enact major changes in city employee benefits and salaries. So while most city officials acknowledge the importance of citizen engagement and the civic sanctity of resident participation, it is hard to overestimate how beneficial a maximum, feasible outreach effort can be.

There are multitudes of ways that communities can foster citizen engagement, and it can involve many different local settings, but an explicit plan to integrate the public in as many useful ways as possible is critical, particularly for garnering the legitimacy that local officials need if they are to make the many tough decisions that mitigating fiscal stress requires. While

there are all kinds of innovations in citizen engagement ranging from process to technology, “old style” engagement continues to work. An intense emphasis on neighborhood meetings, accompanied by widespread dissemination of information, visible feedback, and meaningful evidence that neighborhood sentiment is being engaged and incorporated into decisions all go a long way toward accomplishing the benefits of community engagement.

**Recommendation Three: Improve the state/local relationship, in order to reduce episodic, convulsive impacts on local public finance.**

In California, the state/local relationship is dysfunctional and needs to be improved. There is simply no trust among cities when it comes to California state government, particularly in the wake of the state’s recent, imposed dissolution of city and county redevelopment agencies. As a result, a number of issues cannot realistically be broached. For example, there is a positive role that the state can play in assistance and helping cities develop the analytical tools to provide better and more accessible fiscal data. At this time, however, any effort by the state to raise topics like that is more likely to provoke suspicion that the state is setting up to “police” and “regulate” local affairs. This study takes the position, however, that a more active state role in providing fiscal data across communities in a timely and accessible way is critical to improving the analytical resources available to cities and others interested in local fiscal performance.

It is true that many states have a more intense monitoring role vis-à-vis their local governments (Pew, 2013), and it is also true that compared to other states, California does not play a systematic role in managing financial distress among cities. In fact, most California cities claim that it is the state that is a major source of local fiscal stress. However, this study comes to the conclusion that a good faith, sincere effort to develop a statewide monitoring system for cities would be helpful to cities, the state, and city residents.

Using a variety of models, it would be quite valuable for cities managing fiscal stress and for the state to possibly help communities reduce the damage or depth of fiscal stress. Such a monitoring system would work from a common platform provided by the state and largely paid for by the state (Joffe and Neiman, 2013). There seems to be no inherent reason why such a role should or could not be developed. In California, however, short of the fiscal collapse of a number of cities beyond those that have already been in the news, there is little chance that such an early warning, monitoring system will be supported by local officials or created by the state, reflecting the mutual distrust, rather than opposition to the principle of such a state role.



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While pursuing his Masters in Public Affairs at the University of San Francisco, Jeremy started his research on local government and management of fiscal stress. He successfully completed his capstone project, Features of Generalized Fiscal Stress in California Cities, and then continued to pursue this topic as part of this research publication.

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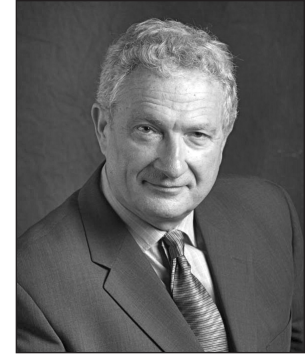
In 2003, Jeremy founded the Global Youth Partnership for Africa (GYPA), an organization that supports community development through sports and microfinance projects in post-conflict regions of East Africa. As Executive Director of the organization, he oversaw all operations, managed partnerships with public and private sector organizations, managed an international staff and raised more than half a million dollars and in-kind contributions for program activities. He has also consulted for private family foundations developing programs in Africa. For example, he consulted on the launch of a 143-acre development project to construct a school campus in Rwanda.

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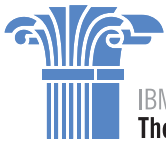
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